

BOARD FOR FINANCING WATER PROJECTS  POLICY	REVISION DATE  05/03/06	PAGE  Page 1 of 3
SUBJECT: DEPRECIATION – CAPITAL REPLACEMENT FUNDS		

#### STATEMENT OF POLICY:

It is the policy of the Board for Financing Water Projects to establish guidelines for the capital replacement funds to assure conformance with NRS 349.

#### PURPOSE:

To establish a policy for the establishment of appropriate capital replacement funds for grant projects.

#### BOARD POLICY:

#### CAPITAL REPLACEMENT RESERVE FUND

The Division calculates depreciation using life expectancies for water facilities as tabulated by the National Association of Regulatory Utility Commissioners. Large and new systems with rigorous maintenance regimens are expected to get the longest lives from their facilities. Older and smaller systems and those whose maintenance work is only done when it can not be postponed any longer are not expected to have long lived facilities. For the purpose of the grant program, average life expectancies are used for all projects.

It is the Board's perspective that every utility should contribute annually to renewal and replacement of its system. If a utility is severely damaged, larger reinvestment in the system is necessary if the system hopes to remain operational or make up for postponed improvements.

Grants awarded to a community to provide for construction of new facilities include a grant condition that the utility will provide not only for the maintenance and operation of the facility but also for the eventual renewal of the facility. The State does not consider a system "viable" or a project "financially feasible" if it is financially unable or unwilling to support the project. Therefore the Board requires that utilities receiving grant funds budget for system renewal.

"Capital improvements" are typically high cost items with long service lives including: the distribution pipe mainlines, treatment plants, storage reservoirs, wells and surface water intakes, etc. Expenditures which qualify as capital expenditures are those required to bring a new facility into service, those which extend the life of an asset and/or enhance its original value with better quality materials or system upgrades. Such costs are generally only approved by the governing board of a utility, are typically planned a year

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or more in advance and are usually constructed after funds for the project have been secured.

Capital improvements do not include such minor expenses as repair clamps, inventory parts and fittings, spare pieces of pipe kept to facilitate repairs, small tools, maintenance supplies such as paint or grease, service contracts and other such day to day supplies. Expenses for these items are properly classified as “operating and maintenance” expenses.

It is not appropriate to use capital replacement funds received from existing customers for system expansion, that is, to extend main lines to serve new areas or customers or to install new services. Funds for the expansion of the system should come from new development, connection fees, assessments or other sources so that those benefiting from the improvement contribute the funds for its construction.

Therefore, the Board imposes a condition on grants to ensure that capital funds raised as a component of water rates are used for the benefit of the existing customers and specifically for the replacement of existing capital facilities. The Board requires a utility to contribute an amount each year to a reserve account created for facility replacement. The amount to be contributed annually to the account is the present value of an ordinary annuity with a factor of one percent (1%) inflation. The interest rate for calculating the annuity is five percent (5%). The schedule of payments may be submitted by the grantee at the completion of the project, or a schedule can be prepared by the Division on request.

Example:

Grant award = \$5,700,000

Life of the asset = 30 years

Interest rate = 5%

With 1% inflation, the amount the fund would accumulate at the end of thirty years of equal annual payments with no withdrawals is \$7,682,739.

The annual deposit needed (ordinary annuity), with interest compounded annually, to reach the target reserve fund amount is \$115,636.

The balance in the reserve account must be clearly identifiable in the audited financial statements as a restricted account of the Water Utility Fund. The Capital Reserve requirement schedule established at the completion of the project will become a binding condition of the grant. The Board must be notified, in writing, when a capital improvement withdrawal from the reserve fund is made and include the amount and nature of the expenditure.



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This new policy on depreciation will not be imposed retroactively; however, a grantee may request a change to the new plan. Requests to diverge from the Board's Policy will be considered on a case-by-case basis.

#### SUMMARY

To ensure the continued viability of water systems receiving State grant funds, the Board for Financing Water Projects requires that any system requesting and receiving State grant money must deposit reasonable and sufficient amounts each year into a restricted capital replacement reserve account.